

Banking Union

AML supervision — institutional framework and recent developments

Alexander Glos, Michael Rohls, Christopher Robinson, Marius Raetz

28 February 2019



Freshfields Bruckhaus Deringer

Agenda

- I Introduction**
- II Institutional Framework**
 - Recent EU proposals
 - Prudential and AML supervision
 - Future role of the EBA
- III Risks**
 - Internal Investigations and Litigation
- IV Conclusion/Wrap-up**



Introduction

Institutional Framework

I. Introduction

FINANCIAL TIMES

ECB withdraws licence of Maltese bank after scandal

Pilatus at centre of murdered journalist's reports of alleged money laundering

Bloomberg

A Danish Scandal Is a Headache for the World

The extent of one bank's alleged money-laundering should trouble regulators globally.

Report

Latvia's money laundering scandal



Latvia's third largest bank ABLV sought emergency liquidity from the ECB and eventually voted to start a process of voluntary liquidation, after being accused by US authorities of large-scale money laundering and having failed to produce a survival plan. What does it mean for the ECB?

What does it mean for the ECB?

Handelsblatt

Money-laundering charges threaten EU banking union

Why the financial crimes of Estonia's Versobank matter for Europe in general, and for Germans in particular.

Why the financial crimes of Estonia's Versobank matter for Europe in general, and for Germans in particular.

Bloomberg

Latvian Bank Faces U.S. Ban Over Money-Laundering Concerns

Compromised defences

The Economist

ING and Danske Bank are in the spotlight for their handling of dirty money

The scandals expose gaps in the EU's anti-money-laundering regime

The scandals expose gaps in the EU's anti-money-laundering regime



ECB shuts Pilatus Bank as EU readies new move on Malta

What's on the agenda



Danske Bank money laundering 'is biggest scandal in Europe'

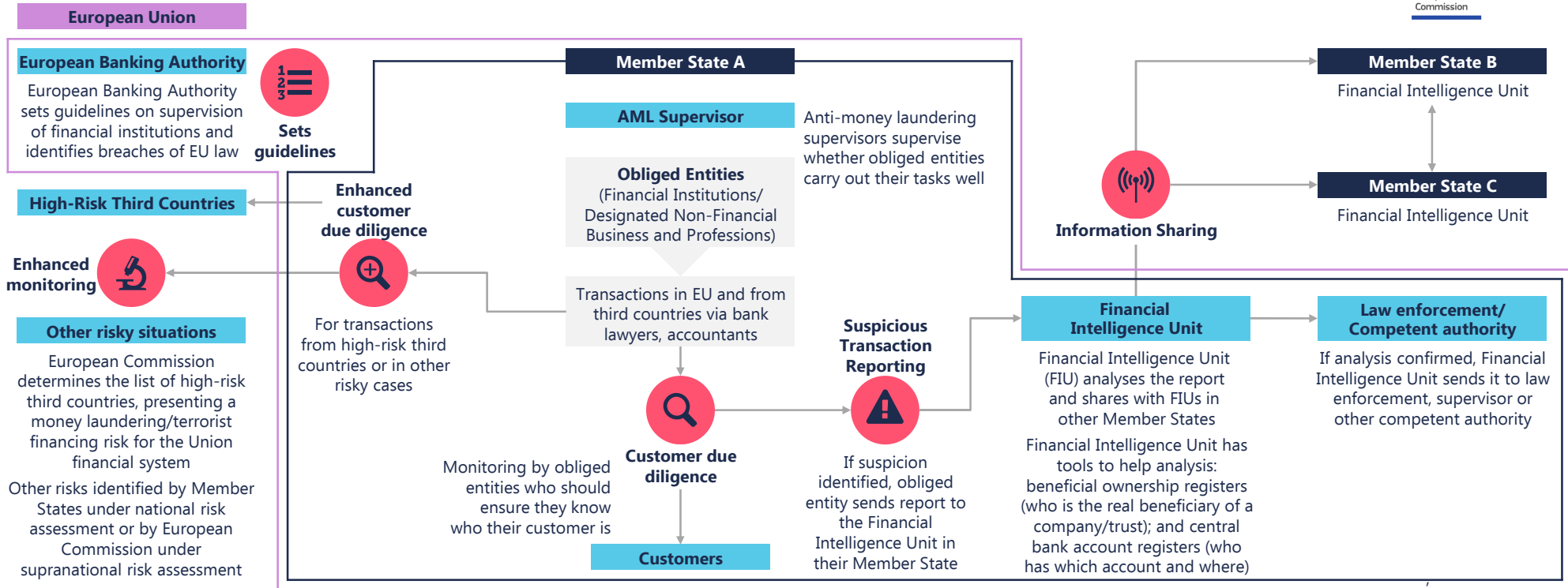
Unpleasant lesson of €200bn case shows need to be vigilant - European commission

European commission

Unpleasant lesson of €200bn case shows need to be vigilant - European commission

I. Introduction

Preventing money laundering and terrorist financing across the EU How does it work in practice?





Institutional Framework

Recent EU Proposals

II. EU Proposals

Background: Recent AML cases

Similarities and differences

- Balance sheets range from 294 million EUR (verso bank) to 864 billion EUR (ING Bank N.V)
- Some institutions are directly supervised by the ECB (ABLV, ING), others are outside the SSM (Danske Bank) or too small (Versobank, Pilatus Bank)
- Several cases are ultimately triggered by events external to EU AML supervision (US authorities, whistle-blower, information by other market agents)
- Several cases involve particular **cross-border elements** and indicate lack of interaction between AML and prudential supervision

Analysis (cf. EGOV for EP, February 2019)

- A robust assessment of systematic AML activity requires information **at transaction level** (ie on-site inspections, whistleblower, information by other market agents)
- **Prudential indicators** are not very telling, as ratios (CET1, Total capital, NPL) often indicate good financial health despite AML activity
- Relevant information is **often scattered**, may original from prudential supervision (ie home state), conduct supervision (ie host state of branch) or AML supervision (host state)
- Possible indicators: High level of non-resident deposits (ABLV, Pilatus, Danske branch), large deposits in non-euro, high ownership concentration

II. EU Proposals

Commission Communication on AML supervision (Sept 18)

Purpose and background:

- Reaction to several recent cases of money laundering in European banks
- Strengthen Union framework for prudential and AML supervision of financial institutions
- Build upon proposal of Joint Working Group of COM, EBA, ESMA, EIOPA and ECB of 31 August 2018

'Why EU Action is necessary':

- **Delayed reactions** & shortcomings to **cooperation and information sharing** among domestic authorities and across borders
- No clear articulation between prudential and AML rules for financial institutions
- Supervision of compliance with AML legislation follows national approach (host country supervision), minimum harmonisation of competences and no harmonisation of powers

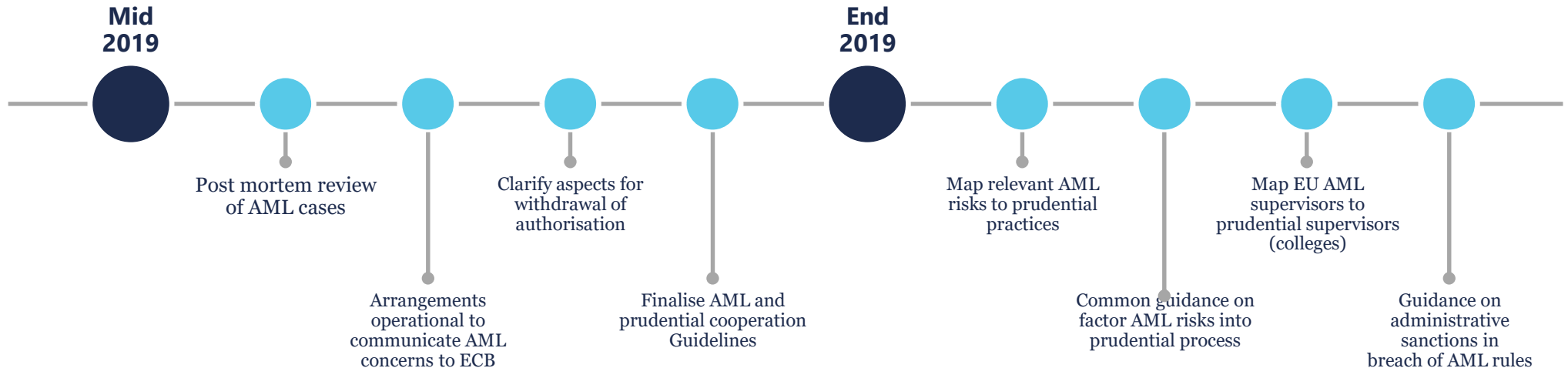
Proposals (selection):

- Changing CRD IV: all relevant authorities and bodies that receive, analyse and process AML-related information explicitly covered by **confidentiality waivers**; explicit **duty of cooperation**
- Revising EBA Regulation: EBA with **centralised AML responsibilities** across the financial sectors (explicit, clear set of tasks and powers, adequate resources)
- Non-legislative: Clarify degree of discretion for prudential supervisors when 'serious breach' has occurred and consistent consideration of consequences of license withdrawal; guidance on best practices for administrative sanctions in cases of breach of AML rules (End of 2019)

II. EU Proposals

Anti-Money Laundering Action Plan (Dec 2018)

Adopted by ECOFIN on **4 December 2018** as reaction to number of alleged AML cases involving EU banks



Two broad themes:

- Strengthening the link between AML and prudential supervision (integration, cooperation and exchange of information, common guidance)
- Improve capacity of ESAs (in particular dedicated AML guidance for prudential purposes)



Institutional Framework

Prudential and AML supervision

I. Prudential and AML supervision

Role of the ECB?

AML supervision not conferred on the ECB

- **SSM-Regulation, rec. 29:** ‘Supervisory tasks not conferred on the ECB should remain with the national authorities. Those tasks should include (...) the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and consumer protection.’
- **SSM-Regulation, rec. 30:** ‘The ECB should cooperate, as appropriate, fully with the national authorities which are competent to ensure a high level of consumer protection and the fight against money laundering.’

Points of contact (overview)

- Granting **authorisations**
- Assessing **acquisitions of qualifying holdings**
- Conducting **fit and proper assessments**
- Ongoing **assessment of risks** (in particular **SREP**)
- **Withdrawal of an authorisation**



(...) important to note that the responsibility for ensuring compliance with anti-money laundering (AML) and countering the financing of terrorism (CFT) legislation remains at the national level and is not part of microprudential supervisory tasks. The ECB, within the remit of its supervisory functions, takes the prudential implications of money laundering very seriously, as the related risks can pose a threat to the viability of supervised entities, as well as to the reputation of supervisors. Nevertheless, the ECB has no mandate to investigate directly any alleged breaches of AML/CFT rules by banks.

Danièle Nouy, Chair of the Supervisory Board of the ECB, 19 December 2018



II. Prudential and AML supervision

The ECB – points of contact (in more detail)

Assessment of ongoing risk and SREP

Assessment of ongoing risk

- Internal governance and assessment of institutions' compliance function and procedures: aims to ensure that institutions have a full system of governance, compliance and internal controls in place to **prevent materialisation of AML risk**
- Business model: the assessment of the potential impact of AML risk on the viability and sustainability of the bank's business models

SREP (in particular)

- **Includes: Assessment of internal governance and institution-wide controls**
- EBA: 'Competent authorities should reflect in SREP assessments available information and outcomes from all other supervisory

activities, including on-site inspections, approvals of internal models, fit and proper and other authorisation approvals, the assessment of recovery plans, market conduct and consumer protection activities, **anti-money laundering and countering terrorist financing activities...**'

- **Operational risk:** ECB takes into account legal and reputational risks arising for banks from AML concerns when it assesses the need for supervisory measures under SREP
- **Potential impact:** Direct (capital add-ons; organisational measures; recalling board members) and indirect (eg effect on variable remuneration)
- The ECB cannot investigate but takes its decision **based on the information available**

II. Prudential and AML supervision

The ECB – points of contact (continued)

Other areas of AML concern

Fit and proper assessments

- Joint ESMA and EBA Guidelines: “*The following factors should at least be considered in the assessment of reputation, honesty and integrity: (...) convictions or ongoing prosecutions for a criminal offence (...) in relation to laws on money laundering...*”
- ECB Guide to fit and proper assessments: “*Pending – as well as concluded – criminal or administrative proceedings, or other analogous regulatory proceedings, may have an impact on the reputation of the appointee and the supervised entity*”

Assessment of acquirer in qualifying holding procedure

- ESAs, Joint Guidelines on the prudential assessment: ‘*Proposed acquirer is or was involved in money laundering operations or attempts, whether or not this is directly or indirectly linked to the proposed acquisition or (...) proposed acquisition increases the risk of money laundering or terrorist financing*’ – target supervisor should oppose the proposed acquisition

- Information about the proposed acquirer gathered during assessment process, evaluations, assessments or reports by international organisations and standard setters, predicate offences to money laundering and combating the financing of terrorism, and open media searches (information from AML authorities/EBA?)

License withdrawal

- Article 18(1) CRD IV and Article 67(1) CRD IV: Authorisation may be withdrawn where ‘*...an institution is found liable for a serious breach of the national provisions adopted pursuant to Directive 2005/60/EC...*’
- No uniform interpretation of **serious breach**, degree of discretion, consistent consideration of consequences of withdrawal (critical functions, resolution, deposit protection, suspend payments (EBA Guidance expected Mid-2019))
- Examples: Pilatus Bank plc, ABLV Bank AS, Versobank AS

II. Prudential and AML supervision

AML-related changes to CRD IV ('CRD V')

1. New. Rec. (11a)

CA shall consistently factor AML concerns into relevant supervisory activities, including SREP, inform accordingly relevant AML authorities and take supervisory measures in accordance with their powers under CRD and Regulation (EU) 2013/575. This should be done on the basis of findings revealed in the authorisation, approval or review processes as well as on the basis of information received from AML authorities.

2. Amended Art. 10

Application for authorisation to be accompanied by a description of internal governance and risk management arrangements, processes and mechanisms (EBA to develop RTS).

3. Amended Art. 56

Professional secrecy and confidentiality shall not prevent information sharing with AML authorities and FIU.

4. Amended Art. 91

Express power to remove members from management body and CA shall in particular verify good repute fulfilled where reasonable grounds to suspect that AML is being or has been committed or attempted, or there is increased risk of AML with that institution (EBA to provide guidelines).

5. New Art. 97(6)

Where review reveals reasonable grounds for AML, notification to EBA and AML authority. If increased risk of AML, CA and AML authority shall liaise and notify common assessment to EBA. CA shall take appropriate measures under CRD.

6. New Art. 97(6)

Express duty of cooperation between CA, FIU and AML authorities provided that cooperation and information exchange do not impinge on an on-going inquiry, investigation or proceeding in accordance with the criminal or administrative law of the relevant MS (compromise) – EBA to provide guidelines and mediation procedure in event of disagreement.

Implementation

- Part of the CRD V package, expected for publication in the EU Official Journal in the next 2 to 3 months (entering into force approx. end 2020)

II. Prudential and AML supervision

Multilateral agreement — exchange of information between ECB and AML authorities

Purpose and background

- Legal basis: Article 57a(2) AMLD5 requires the ESAs to support conclusion of agreement on practical modalities for exchange of information between the ECB and CA
- Enhance the cooperation and information exchange between ECB and AML/CFT supervisors through a clear legal mandate

Content

- Type of information that can be exchanged (at request or own initiative) from AML to ECB or ECB to AML and process for exchange
- Agreement is vague on grounds for denial and states that requested participant may decline where request or fulfilling the request would violate applicable laws
- Confidentiality and data protection
- Settlement of disputes procedures w. ESAs

Implementation

- Sent to the ECB and the competent AML authorities for signature on 15 January 2019

II. Prudential and AML supervision

EBA Guidelines on cooperation and information exchange for AML/CFT supervision

Reasoning:

- Directive (EU) 2015/849 requires but does not set out in detail how competent authorities should cooperate
- Inspired by existing prudential colleges of supervisors (Art. 116 CRD IV) – some prudential colleges already have AML-specific substructures
- To improve cooperation and information exchange through AML/CFT colleges

Main instruments:

- Creation of AML/CFT colleges of supervisors
 - Mapping exercise of all firms under AML supervision to identify those firms that require an AML/CFT college to be set up
 - Different triggers for EU firms and non-EU undertakings (next slide)
 - Scope of mutual assistance
- Cooperation between AML/CFT colleges and colleges of prudential supervisors
- Framework for bilateral relationships

Implementation process

- Consultation process for comments closed on 8 February 2019
- Final Guidelines expected in Mid-2019

II. Prudential and AML supervision

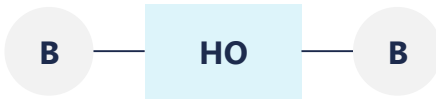
EBA Guidelines - mapping of AML colleges

Supervisory Cooperation Guidelines: Establishing AML/CFT Colleges

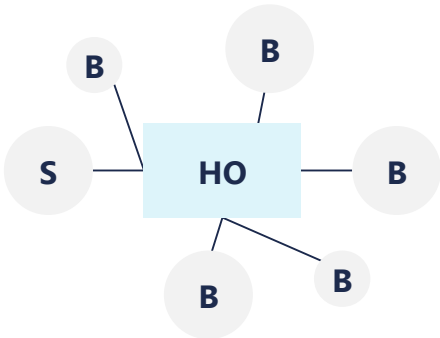


EU Member States

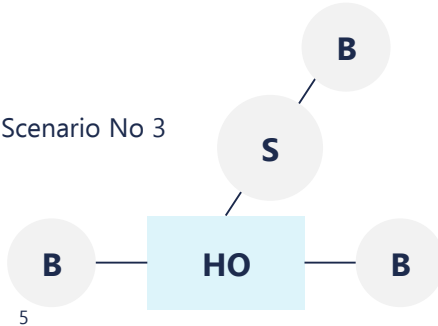
Scenario No 1



Scenario No 2

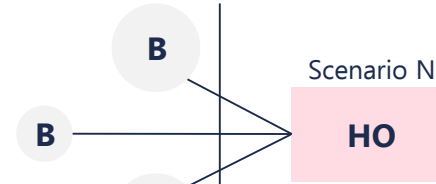


Scenario No 3



3rd Countries

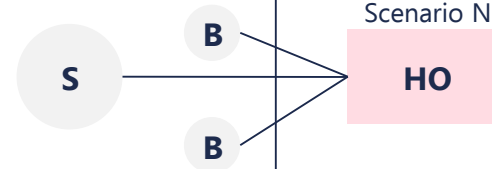
Scenario No 4



Scenario No 5



Scenario No 6



II. Prudential and AML supervision

ECB – establishing an AML office



'We are also working on intensifying our prudential work on this topic, by creating a coordination function for SSM related AML issues within ECB Banking Supervision, in full respect of the allocation of anti-money laundering responsibilities within the current legal framework. This "AML office" is intended to fulfil three roles.' – Daniele Nouy, Chair of the Supervisory Board, 20 Nov 2018

Single point of entry for AML authorities

Chair of AML network among Joint Supervisory Teams

Centre of expertise

There is currently no initiative to establish a European AML authority, but COM proposes fundamental review of AML framework including possible need for new EU body in accordance with review clause of AMLD5 (Jan 2022) – ECB has also publicly called for EU agency (in reaction to ABLV case)



Institutional Framework

Future role of the EBA

II. Future role of the EBA

Current mandate

The EBA discharges its functions in AML by:



- facilitating and fostering the cooperation of competent AML/CFT authorities across the EU
- working closely with ESMA and EIOPA, through the **Joint Committee**, to promote the development of a common understanding, by competent authorities and credit and financial institutions, of what the risk-based approach to AML/CFT entails and how it should be applied
- working with ESMA and EIOPA, through the **Joint Committee**, to deliver its mandates AMLD and Fund Transfer Regulation; and
- engaging in dialogue with its stakeholders and international standard-setters

‘However, bolder steps need to be taken to ensure that anti-money laundering risks are systematically, effectively and consistently incorporated into supervisory strategies and practices of all relevant authorities. **The European Banking Authority will play a key role in achieving this.**’

Communication from the Commission, Strengthening the Union framework for prudential and anti-money laundering supervision for financial institutions, 12 September 2018

II. Future role of the EBA

Current powers and legal instruments

Powers and legal instruments to achieve ESAs objectives



Legal Instruments

- Draft Technical Standards
- Guidelines, Recommendations and Opinions

Powers

- Breach of Union law investigations
- Non-binding mediation
- Peer reviews

Other Tools

- Training
- Supervisory convergence assessments
- Discussions at relevant internal committees
- Bilateral liaison with individual competent authorities

II. Future role of the EBA

Overview AML instruments (Draft RTS, Guidelines, Opinions)

Setting AML/CFT expectations and standards



Policy Objective:

A proportionate, risk-based approach that is based on cooperation and information-sharing, and that is enforced appropriately and consistently by supervisors across the EU.

Draft RTS on AML/CFT group policy in 3rd countries (Art 45(5) AMLD)

Draft RTS on Central Contact Points (Art 45(10) AMLD)

Guidelines on Risk Factors (Art 17 and 18(a) AMLD)

Guidelines on Risk-based Supervision (Art 48(10) AMLD)

Guidelines on Funds Transfers (Art 25 AMLR)

Opinion on ML/TF Risk (Art 6(5) AMLD)

Opinion on The use of RegTech solutions

Opinion on CDD for Asylum Seekers

Draft guidelines on Supervisory Cooperation (under consultation)

II. Future role of the EBA

Proposal for amended Regulation (EU) 1093/2010 (EBA-R)

Increased AML staffing (COM prop):

Currently	2 FTE
2019	4 FTE
2020+	10 FTE

EBA already builds reserve list of candidates



New body for decision-making:

Permanent internal committee of high-level AML representatives of MS and EBA, ESMA and EIOPA (without right to vote) and observers of COM, ESRB, ECB to prepare draft decisions

New obligations for EBA to act

Obligation for EBA to maintain central AML database (data hub) and to make sure that data is analysed and made available to CA on 'need to know basis' (Art. 9a(2))

Obligation to perform risk assessments of CA to evaluate strategies and resources and inform COM of results

II. Future role of the EBA

Proposal for amended Regulation (EU) 1093/2010 (EBA-R) continued

New Powers

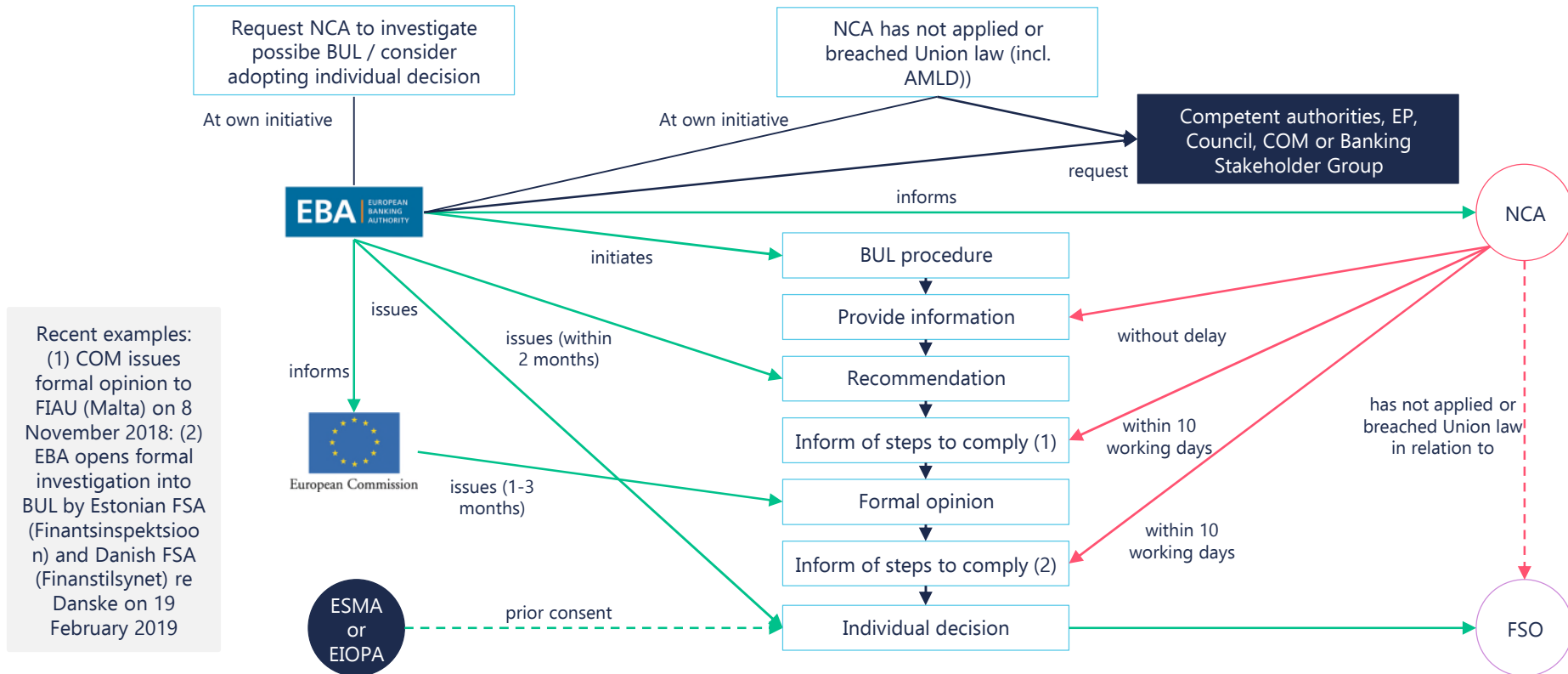
- Breach of union law (Art. 17 EBA-R)
 - Direct supervisory powers over institutions to enforce all relevant Union law (incl. national law transposing Directives)
- Request for investigation (Art. 9b EBA-R)
 - NCA shall investigate alleged AML case at EBA request and EBA may request NCA to adopt decision
- Settlement of disagreement (Art. 19 EBA-R)
 - NCAs can refer disagreement to EBA (but scope in AML cases unclear)

Enhanced existing powers

- AML tasks for EBA (Art. 9a EBA-R)
 - AML becomes a specific task for EBA (and not just implicit as part of sector-related tasks)
- Convergence instruments
 - All convergence instruments explicitly apply to AML (Art. 9a EBA-R)
- Peer reviews
 - Explicit periodic independent reviews with input from the AML Standing Committee at EBA; information to EP, COM, Council
- Collection of information from prudential and AML authorities on identified (material) AML weaknesses (Data Hub)

II. Future role of the EBA

Breach of Union law (Art. 17 EBA-R)





Risks

Internal Investigations and Litigation

III. Risks

Internal Investigations/Reviews

- Pro-active investigation to understand scope and causes of AML breaches crucial to managing regulatory and wider relationships
- Review needs to be designed with expectations of ECB as well as national supervisory authorities and other stakeholders in mind
- Crucial to ensure investigation captures full geographic scope of issue (eg all parts of the bank involved directly or indirectly in problematic cash flows) given co-ordination between national authorities under ECB and likelihood of enquiries from different jurisdictions
- For serious breaches unlikely to enable bank to avoid investigation and penalty but:
 - key to sending message to regulators and other stakeholders of management commitment
 - enables remedial work on systems and controls to be undertaken swiftly
 - enables bank to keep pace with regulators as they seek and exchange information (avoid reactive/catch up approach)
- Points are essential to ensuring best outcome from ECB and other authorities

III. Risks

Litigation Risks

- AML crises increasingly spawn follow on litigation for European banks due to increased publicity, rise in claimant law firms new forms of mass claims and collective redress, and US approach to accepting jurisdiction in civil claims.
- Three main categories of litigation risks:**
1. Follow on claims from investors where securities have fallen in value post announcement of AML problems
 2. Claims from persons (eg governments) against banks who have effected transfers of cash rightly belonging to them
 3. Claims from victims of underlying criminal conduct facilitated by money laundering (eg U.S. Anti-Terrorism Act, tax evasion, sanctions, organized crime)
- Parallel litigation can occur in multiple jurisdictions (eg where securities are traded on European exchanges and ADRs in the US) – requires a global litigation strategy, in particular re choice of forum, choice of law, different rules of legal protection, or non-protection, of evidence
 - Litigation may commence while investigations are in progress. Internal investigation likely focus of claimant attack. Need for careful co-ordination in approach/document creation



Summary conclusion

[insert sub]

Our speakers



Dr. Alexander Glos

Corporate

T +49 69 27 308 191

E alexander.glos@freshfields.com

About

- A financial services lawyer specialising in banking and investment services regulation, with close knowledge of the German and European financial regulators.

Skills and experience

- Alexander advises banks and other financial institutions, and also unregulated entities, on all areas of financial services regulation. He specialises in banking and investment services regulation, as well as payment services and capital markets regulation. Alexander works with financial institutions and investors on M&A and loan portfolio transactions, as well as bank restructurings and other financial market stabilisation measures. His recent experience includes advising two banks with regard to the Comprehensive Assessment by the European Central Bank as well as one bank in relation to a proceeding with the Administrative Board of Review of the European Central Bank.



Marius Rätz

Corporate

T +49 69 27 308 214

E marius.raetz@freshfields.com

About

- Marius advises financial institutions and financial market participants on matters of regulatory law.

Skills and experience

- Advising global credit institutions on the amendment of contractual documentation and operational arrangements in the context of Brexit (clearing of derivatives, prime brokerage); advising one bank in proceedings before the European Court of Justice in relation to the SSM; advising on legal remedies against “failing-or-likely-to-fail” assessment in the context of resolution proceedings; continuously advising on broad range of questions in clearing and settlement; advising credit institutions on the implementation of MiFID II

Our speakers



Christopher Robinson

Dispute Resolution

T +44 20 7427 3047

E christopher.robinson@freshfields.com

About

- Christopher is a partner in our financial institutions disputes resolution group and based in London. He advises on a wide range of litigation and regulatory proceedings in the banking and financial services sector. He is a member of the firm's global investigations practice and frequently works on cross-border investigations with a financial services or financial crime focus.

Skills and experience

- Advising a leading global financial services firm on an FCA regulatory investigation into its financial crime systems and controls; Advising a leading European bank on allegations of money laundering and bribery and corruption, including investigation, reporting and resolution; Advising a legal global investment bank on its handling of suspicious transaction reporting; Advising UK Finance on information sharing between financial institutions for AML related purposes; Advising a global investment bank on following on litigation mass claims in relation to allegations of financial misconduct.



Michael Rohls

Dispute Resolution

T +89 20 70 22 21

E michael.rohls@freshfields.com

About

- Michael specialises in international and domestic civil litigation and arbitration. As well as post-M&A disputes and commercial litigation, he focuses on finance disputes and distribution law. He also acts as an arbitrator. Clients come back to Michael again and again for his experience in national and international disputes. His personal involvement, tenacity and hands-on approach are greatly valued. Michael is the Office Managing Partner of our Munich office.

Skills and experience

- Representing BayernLB regarding its €7bn claims for repayment of loans by Hypo Alpe Adria (HETA) in state courts in Germany and Austria, involving complex issues of international bail-in rules and equity compensation laws; Defending the British insurer Scottish Widows (former Clerical Medical) against the one of the largest mass claims in Germany (over 1600 court cases at 106 German courts); Representing EnBW against former managers in respect of D&O claims in an amount of around €240m; Representing private equity clients in several international post-M&A arbitrations under DIS and ICC rules; Continuously advising vehicle manufacturers on distribution law, international product liability, supply agreements, and general commercial issues; and acting as a presiding arbitrator.

Thank you

Diese Informationen sind nicht als umfassende Darstellung gedacht und können eine individuelle Rechtsberatung nicht ersetzen.

© **Freshfields Bruckhaus Deringer LLP 2019**

DS36162